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## The equity bull market that no-one trusts

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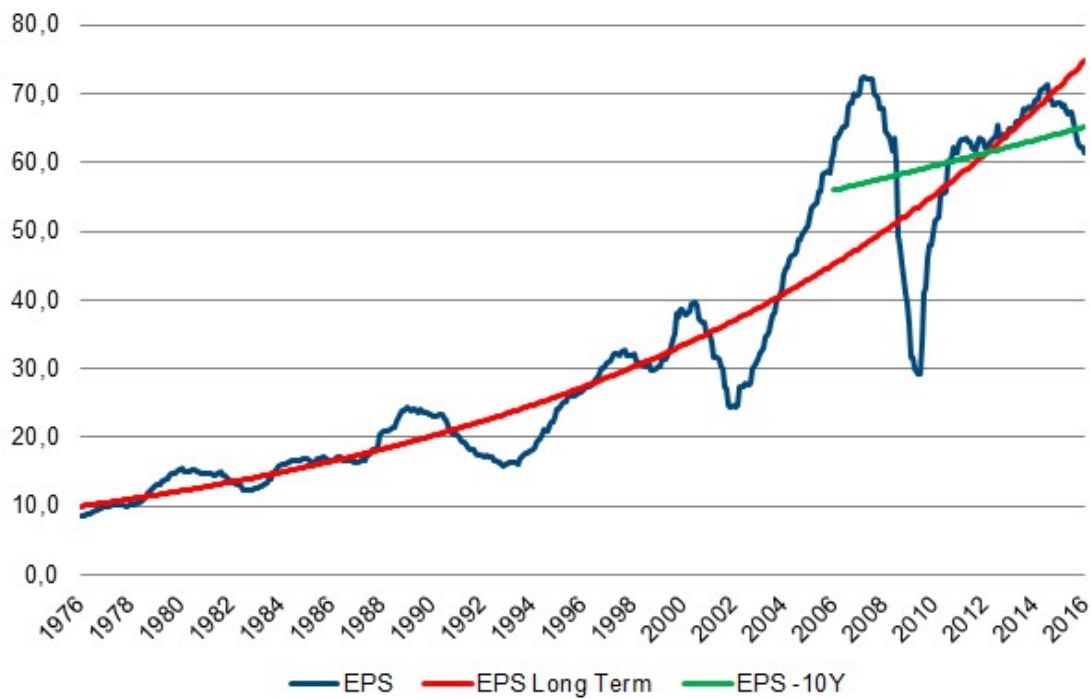
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Equities got off to a terrible start into 2016. At the end of February, a short but intense sell-off was triggered by the emergence of concerns over a slump of the global economy in connection with China. However, since mid-February the international indices have been on the rise without any significant breaks. Not even the much-feared Brexit vote managed to dent the upswing. Although share prices were down in the immediate wake of the decision of the UK to leave the EU, they rebounded very swiftly.

### Scepticism due to falling earnings

What is the reason for the broad cloud of scepticism that has been hovering over the rising prices? A glance at the current earnings development of the shares contained by the MSCI World index illustrates why investors are astonished by the performance displayed on the market:

## Global equity markets – EPS and trends



Source: MSCI; Datastream  
EPS: Earnings per share  
Long term trend – red line  
EPS -10Y: 10 year trend – green line

The chart shows that earnings have been on a continuous decline for one and a half years. In the past 40 years there have been only five periods during which EPS were falling for longer – and only during a recession as well. This means that for the first time since the 1970s we have a period of falling earnings without a recession! It is part of the basic working knowledge of any investor that earnings drive prices in the long run. And if not current earnings, then at least expected earnings.

### Developed markets are expensive

From a fundamental perspective, prices can also rise without rising earnings: when the markets command attractive valuations. In the long run, valuations tend towards their average, i.e. every attractive valuation will tend towards a “normal” valuation.

	PE	AVG P/E (40Y, EM 20Y)	PTB	AVG P/B (40Y, EM 20Y)	DY
WORLD DM	21,3	17,9	2,2	2,1	2,6
WORLD EM	14,8	15,1	1,5	1,8	2,6
USA	23,0	17,3	2,9	2,4	2,1
CAN	25,0	20,8	1,9	1,8	2,9
EUR ex UK	20,3	16,5	1,7	1,7	3,4
UK	22,3	13,6	1,8	1,9	3,9
SWI	21,5	19,3	2,4	2,3	3,3
AUT	9,2	20,1	1,0	1,6	2,7
JAP	15,8	27,0	1,2	2,1	2,3
KOR	10,9	19,8	1,0	1,3	1,7
AUS	17,5	15,4	1,9	1,8	4,4
Hong Kong	14,9	14,9	1,2	1,7	2,9
CHINA	12,9	15,3	1,6	1,9	2,3
INDIA	22,3	17,5	3,2	3,1	1,3
BRAZIL	20,1	12,6	1,5	1,5	3,5
RUSSIA	7,4	7,0	0,8	1,2	4,6
TURKEY	9,4	12,2	1,2	2,6	2,8

Sources: MSCI; Datastream

PE: price/ earnings  
 AVG PE: average PE (historic data)  
 PTB: price/book value  
 DY: dividend yield

The valuation table highlights the fact that the developed markets in particular are relatively expensive. This means that currently share prices are not rising to balance any undervaluation.

### Low yields fuels hunt for dividends

This begs the question: what, if not earnings or valuations, is driving share prices up? A possible, and likely answer is, the lack of alternatives. Savings book rates are as low as they can go. Bond yields around zero push investors into risky investments. This may also explain why shares with strong dividends have shown a particularly good performance; in the absence of bonds that pay positive yields, conservative equities with an attractive dividend yield are the next-best thing. As long as yields remain low, the hunt for shares with strong dividends may continue even though earnings are falling and equities are expensive from a historic perspective.

That being said, falling earnings and high valuations should still make for a cautious approach on the investor's part. Buying the market indiscriminately can come with disastrous results. In this environment, a selective approach is more and more important. However, neither the earnings development nor valuations are suitable as timing instrument.

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